

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7056

Joint Petition of Verizon Communications, Inc. and)	
MCI, Inc. for approval of an Agreement and Plan of)	Hearings at
Merger resulting in MCI becoming a wholly-owned)	Montpelier, Vermont
subsidiary of Verizon)	October 6 & 7, 2005
)	

Order entered: 11/29/2005

PRESENT: James Volz, Board Chairman
David C. Coen, Board Member
John D. Burke, Board Member

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I. BACKGROUND AND OVERVIEW

A. Introduction

This proceeding concerns a joint petition ("Petition") filed by Verizon Communications, Inc. ("Verizon") and MCI, Inc. ("MCI") (collectively, the "Petitioners") with the Vermont Public Service Board ("Board") requesting approval of an Agreement and Plan of Merger ("Merger Agreement") pursuant to 30 V.S.A. §§ 107 and 311. Completion of the proposed transaction would result in MCI and its Vermont operating subsidiaries becoming wholly-owned subsidiaries of Verizon. The Petitioners also seek approval of a related purchase by Verizon of 13.4% of outstanding MCI stock from one of MCI's largest shareholders.

In this Order the Board grants conditional approval under 30 V.S.A. §§ 107 and 311 to the proposed merger and related transactions between Verizon and MCI. We conclude that the merger will satisfy the fifteen criteria applicable to reviews under section 107, including that it is likely to provide some efficiencies. We also conclude that the merger, subject to the following conditions, will not impair or obstruct competition in the Vermont local exchange or toll markets.

Approval is granted subject to the following conditions:

1. Pricing for all MCI mass market services offered under the MCI Neighborhood Plan is capped at current rates for existing subscribers for a period of one year;
2. Verizon must provide fair and non-discriminatory treatment to all users of its Internet Protocol backbone.

B. Procedural History

On March 9, 2005, the Petitioners filed a Petition with the Board requesting approval of the acquisition of MCI by Verizon pursuant to a Merger Agreement dated February 14, 2005. The proposed transaction involves the merger of Verizon and MCI, the parent holding companies of various Vermont operating subsidiaries. As a result of the merger, MCI will become a subsidiary of Verizon. Petitioners filed amended Merger Agreements with the Board on April 12, 2005, and May 6, 2005. In addition, on May 13, 2005, Verizon filed a letter notifying the Board of its purchase of a 13.4% share of MCI stock from Carlos Slim Helu (the "Slim Transaction").

On June 8, 2005, the Board held a prehearing conference in this docket. At the prehearing conference the Board set a schedule for the remainder of the docket and outlined several issues likely to be relevant to the proceeding. The parties also agreed that the Slim Transaction would be subsumed within this docket. On July 19, 2005, a public hearing was held via Vermont Interactive Television sites situated throughout the state. No comments regarding the merger were entered at the public hearings. Technical hearings were held on October 6-7, 2005.

On June 17, 2005, the Petitioners filed a letter with the Board stating that the parties stipulate that there is no dispute as to the Petitioners' satisfaction of six of the fifteen criteria, established by the Board in Docket Nos. 5900 and 6150, for evaluating merger transactions under Section 107.

C. Statutory Framework

The Board's authority to review the proposed Merger Agreement relies on two statutory provisions: 30 V.S.A. §§ 107 and 311. 30 V.S.A. § 107(a) provides, in relevant part, that:

No company shall directly or indirectly acquire a controlling interest in any company subject to the jurisdiction of the public service board, or in any company which, directly or indirectly has a controlling interest in such a company, without the approval of the public service board. . . .

"Controlling interest" is defined in subsection (e)(1) to mean ten percent or more of the outstanding voting securities of a company.¹

As a result of the merger, the entire control of MCI, including its certificated Vermont operating subsidiaries, will be transferred to Verizon.² Therefore, the merger represents an acquisition by Verizon of a controlling interest in a company subject to the jurisdiction of the Board, and Section 107 approval is required.

30 V.S.A. § 311 explicitly covers mergers of public utility companies. It provides in relevant part as follows:

A consolidation or merger under the provisions of this chapter shall not become effective without the approval of the public service board after due notice and opportunity for hearing

1. The statute also allows the Board to vary the ten percent number, following notice and hearing. 30 V.S.A. § 107(e)(1).

2. Petition at 1.

The Board has previously held that this language refers to a merger of any company that is subject to the jurisdiction of the Board under 30 V.S.A. § 203.³ The Board has held that Section 311 applies to the merger of parent corporations of companies subject to Board jurisdiction.⁴

In addition, Section 311 provides that a merger shall not become effective unless the Board makes a finding that the merger:

will not result in obstructing or preventing competition in the purchase or sale of any product, service or commodity, in the sale, purchase or manufacture of which such corporations are engaged. . . .

Section 311 review is required here for two independent reasons. First, the proposed merger affects the parent company of MCI's Vermont operating subsidiaries. Second, the proposed merger involves the parent company of Verizon's Vermont operating subsidiaries.

In Docket No. 5900, the Board reviewed a proposed merger between NYNEX and Bell Atlantic under both sections 107 and 311. In the final Order in that case, the Board identified fifteen criteria that inform the overall "general good" standard of Section 107.⁵ We will follow the same procedure here. Each of the fifteen is discussed separately below.

D. Positions of the Parties

Petitioners maintain that the proposed merger meets all fifteen requirements that the Board has articulated for approval of a merger under section 107. Petitioners assert that their companies have complementary networks, services, and areas of expertise. MCI, through its operating subsidiaries, has a significant base of enterprise customers and an Internet Protocol-based national and international network. Verizon's Vermont operating subsidiaries provide residential and small business services with a large local exchange and wireless network. Petitioners assert that the combination of these assets will have immediate benefits for enterprise customers.⁶ Petitioners also maintain that enhanced competition for enterprise customers and the increased investment in MCI's networks will ultimately benefit consumers and small businesses

3. Docket 5900, Order of 2/26/97 at 19.

4. *Id.*

5. Docket 5900, Order of 2/26/97 at 9.

6. Hallbach pf. at 2, 28; Vasington pf. at 5.

as well. Petitioners also assert that the merger meets the requirements of Section 311 in that it will not obstruct or impair competition in either the enterprise services or the local or toll telecommunications markets.

The Department does not object to approval of the merger. However, the Department asserts that the merger will result in the loss of a substantial competitor in the residential and small business market and will further increase the already dominant share held by the acquiring company. Therefore, the Department maintains, the proposed merger will obstruct and impair competition in Vermont. Accordingly, the Department recommends that the merger be approved subject to certain conditions to mitigate the potentially harmful effects of the merger upon competition. The Department recommends that the Board: (1) require Verizon New England Inc., d/b/a Verizon Vermont ("Verizon VT"), to incorporate commercial agreement results into the Performance Assurance Plan ("PAP"); (2) investigate whether Verizon VT's intrastate special access prices are reasonable and, if not, require a reduction in those rates; and (3) establish a price cap for all mass market services offered to existing subscribers under MCI's "The Neighborhood" plans at pre-merger rates for a period of six to twelve months.⁷

II. FINDINGS

A. Description of the Transaction

1. Verizon is a Delaware corporation that owns telephone operating companies that provide telecommunications services in 29 states, Puerto Rico, and the District of Columbia, serving 53 million access lines. Petition at 2.

2. Although Verizon provides no services and is not a regulated telecommunications carrier in Vermont, Verizon's local telephone subsidiaries, including Verizon VT, are subject to public utility regulation within the jurisdictions in which they operate. *Id.*

3. Verizon VT is a subsidiary of Verizon and provides regulated telecommunications services in Vermont. *Id.*

4. Verizon is also the majority shareholder of Verizon Wireless which provides wireless telecommunications services in Vermont. Vasington pf. at 5.

7. Department Reply Brief at 5-15.

5. MCI is a Delaware corporation and a parent company to several telephone operating companies that provide telecommunications services throughout the United States and internationally. Petition at 3.

6. Although MCI provides no services and is not a regulated telecommunications carrier in Vermont, some of its operating subsidiaries are subject to public utility regulation within the jurisdictions in which they operate. *Id.* at 4.

7. Several of MCI's operating subsidiaries are authorized by the Board to provide telecommunications services in Vermont, including: MCImetro Access Transmission Services, LLC; MCI Communications Services, Inc.; MCI Network Services, Inc.; Teleconnect Long Distance Services and Systems Company; and TTI National, Inc. (collectively referred to as the "MCI Vermont Subsidiaries"). Hallbach pf. at 2-3.

8. Pursuant to a Merger Agreement between Verizon and MCI, MCI will become a wholly-owned subsidiary of Verizon and the MCI Vermont Subsidiaries will become indirect subsidiaries of Verizon. MCI's shareholders will receive Verizon common stock equal to the greater of .5743 shares or the quotient obtained by dividing \$20.40 by the Average Parent Stock Price, and a special dividend in the amount of \$5.60 per share, less the per share amount of any dividends declared by MCI between February 14, 2005, and the completion of the transaction. Petition at Exh. 1; *see* letter to Board dated April 12, 2005, attaching First Amendment; letter to Board dated May 6, 2005, attaching Second Amendment.

9. Pursuant to a separate agreement dated April 9, 2005, Verizon agreed to purchase approximately 43.4 million shares of MCI common stock, representing approximately a 13.4% ownership stake, from eight holding companies affiliated with Carlos Slim Helu for approximately \$1.1 billion in cash (the Slim Transaction). Exh. Verizon-PBV-2.

10. The Merger Agreement does not call for the merger of any assets, operations, lines, plants, franchises, or permits of MCI's regulated subsidiaries with the assets, operations, lines, plants, franchises, or permits of any Verizon subsidiary. Petition at 5.

11. Upon completion of the transaction, there will be no change in the rates, terms and conditions of service for provision of services currently offered by the Petitioners in Vermont. Petition at 5; Vasington pf. at 4, 23-24.

12. To the extent that any reorganization or change to the terms and conditions of service might be made at a later date, it will be subject to such regulatory approvals as required by the Board and other entities. *Id.*

B. Section 107

Approval under 30 V.S.A. § 107 can be granted when the acquisition promotes the public good. In Docket No. 5900, the Board reviewed a proposed merger between NYNEX and Bell Atlantic under both sections 107 and 311. In the final Order in that case, the Board identified fifteen criteria that inform the overall "general good" standard of Section 107.⁸ In Docket No. 6150, the Board reviewed a merger between Bell Atlantic and GTE, using the fifteen criteria established in Docket No. 5900.⁹ In that order, the Board held that not all fifteen criteria are of equal importance and noted that it is primarily interested in five criteria regarding the surviving entity (Criteria Nos. 9, 12, 13, 14, and 15).¹⁰ The Board concluded that "[w]hile each of the fifteen items may be considered in reaching a decision, that decision, finally, consists of determining whether, based on the record, and balancing all of the factors, the public good standard is satisfied."¹¹ Each of the fifteen is discussed separately below.

Criterion 1 - Legal Authority

Legal Standard

The first criterion for approval of the proposed merger is that the company has authorization from the Federal Communications Commission to provide the proposed services.

Finding

_____13. The Petitioners and the Department have stipulated and we find that this criterion has been met. Letter to Board from Petitioners dated June 17, 2005.

8. Docket 5900, Order of 2/26/97 at 9.

9. Docket 6150, Order of 9/13/99.

10. *Id.* at 48-49.

11. *Id.* at 48.

Criterion 2 - Emergency Services

Legal Standard

The second criterion for approval of the proposed merger is that emergency services must be available.

Finding

____ 14. The Petitioners and the Department have stipulated and we find that this criterion has been met. Letter to Board dated June 17, 2005.

Criterion 3 - Compatibility

Legal Standard

____ The third criterion for approval of the proposed merger is that the system must be compatible with neighboring systems.

Finding

____ 15. The Petitioners and the Department have stipulated and we find that this criterion has been met. Letter to Board dated June 17, 2005.

Criterion 4 - Terms of Service

Legal Standard

The fourth criterion for approval of the proposed merger is that terms and conditions of service are just and reasonable.

Findings

16. Verizon VT is currently operating in Vermont as a local exchange carrier and has comprehensive tariffs and special contracts on file at the Board for the intrastate services it provides in Vermont. Petition at 2-3.

17. Following the merger, Verizon VT will continue to provide service at the same rates, terms and conditions of service as before the merger. Any changes will be subject to Board approval. Vasington pf. at 23-24.

18. The MCI Vermont Subsidiaries operate under Certificates of Public Good issued by the Board and provide intrastate telecommunications services under tariffs on file with the Board. Vasington pf. at 4.

19. Following the merger, the MCI Vermont Subsidiaries will continue to provide service at the same rates, terms, and conditions as before the merger. Any changes will be subject to Board approval. Vasington pf. at 4.

Discussion and Conclusions

This fourth criterion is principally designed to review the proposed terms of service of a new entrant.¹² Since both Verizon VT and the MCI Vermont Subsidiaries are established carriers, there is no need here to perform a comprehensive review of their existing tariff structures. To the extent that Petitioners will be providing service both before and after the merger under the same tariffs, criterion four is satisfied.

Criteria 5 and 6 - Service Quality and Customer Service

Legal Standard

The fifth criterion for approval of the proposed merger is the adequacy of service quality. The sixth criterion for approval of the proposed merger is the adequacy of customer service, including the processing of customer complaints.

Findings

20. The terms of the Merger Agreement require no change to the operations of the regulated subsidiaries of either MCI or Verizon. Therefore, the merger will have no impact on the level of service quality and customer service offered by the Petitioners. Vasington pf. at 23-24.

Discussion and Conclusions

For companies with a presence in Vermont, the key consideration is that the proposed merger not have adverse effects on service quality or customer service.¹³ The record evidence indicates that the merger of the Petitioners will have no impact upon either the service quality or

12. See Docket 6150, Order of 9/13/99, at 10.

13. Docket 6150, Order of 9/13/99, at 15.

the customer service provided by the Petitioners through their regulated subsidiaries. The operating companies will remain subject to the Board's rules and orders concerning telecommunications service quality and customer service. In addition, Verizon VT will remain subject to the retail service quality standards established in Docket No. 6959.¹⁴ Therefore, the Board concludes that service quality and customer service will not be adversely affected by the merger.

Criterion - 7 - Quality of Facilities

Legal Standard

The seventh criterion for approval of the proposed merger is that the quality of facilities must be adequate.

Findings

21. The merger transaction will not result in the merger of any assets, operations, lines, plants, franchises, or permits of the MCI Vermont Subsidiaries with the assets, operations, lines, plants, franchises, or permits of any Verizon entity. Petition at 5.

22. The merger will not result in any changes to the quality of the facilities provided by Verizon VT. Vasington pf. at 4.

23. MCI owns very few facilities and leases a limited number of facilities in Vermont. MCI does not own any local loop facilities and owns or controls only a small amount of fiber transport facilities in Vermont. Hallbach pf. at 5-6; Lackey pf. at 14-15.

24. The quality of the facilities of the consolidated entity will be adequate. The acquisition will increase MCI's financial capacity to invest in its network and may allow Verizon to reduce capital expenditures that would have otherwise been necessary to replicate an enterprise service network competitive with MCI's. At worst, the merger will likely do no harm to the quality of the Petitioners' facilities. Lackey pf. at 17-18.

Discussion and Conclusions

The terms of the Merger Agreement contemplate no change to the operations of Verizon VT or the MCI Vermont Subsidiaries. MCI owns few facilities in Vermont and the merger will

14. Docket 6959, Order of 9/26/05 at Appendix C.

have no impact on Verizon VT's facilities. The merger may allow the entities additional financial capacity to invest in their networks. Therefore, we conclude that this criterion is satisfied.

Criterion 8 - Rate of Investment

Legal Standard

The eighth criterion for approval of the proposed merger is that the rate of investment will be adequate to provide the contemplated services.

Findings

25. Verizon has committed to invest \$2 billion in MCI's enterprise network and information technology platforms worldwide. Vasington pf. at 19.

26. It is reasonable to expect that Verizon's rate of investment in MCI's enterprise network will be adequate to meet customer demand. Lackey pf. at 18.

27. The merged entity should have the financial capacity to sustain MCI's current business. *Id.*

Discussion and Conclusions

There is no reason to believe that the merger will adversely affect the rate of investment by Verizon VT in its intrastate operations. The Board has also recently established an annual investment floor for Verizon VT's investment in Vermont in Docket No. 6959.¹⁵ In addition, Verizon has committed to substantial investment in MCI's enterprise network and information technology platforms. Therefore, we conclude that this criterion has been satisfied.

Criterion 9 - Financial Stability

Legal Standard

The ninth criterion for approval of the proposed merger is that the acquiring company must be financially stable and sound.

Discussion and Conclusions

The Petitioners and the Department have stipulated that this criterion has been met.

15. Docket 6959, Order of 9/26/05 at Appendix B.

Criterion 10 - Affiliate Interests**Legal Standard**

The tenth criterion for approval of the proposed merger is that the company take satisfactory steps to control affiliate interests.

Findings

28. Currently Verizon addresses affiliate interests through affiliate transaction agreements and cost allocation practices. Lackey pf. at 18.

29. The Vermont operating subsidiaries of the Petitioners will remain regulated by the Board and subject to the same standards that currently apply to affiliate transactions. Vasington pf. at 4.

Discussion and Conclusions

The merger requires no change to the operations of the Vermont regulated affiliates of the Petitioners. Should Verizon seek to eliminate existing MCI subsidiaries following completion of the transaction, Verizon will need to gain Board approval. Therefore, we conclude that this criterion has been satisfied.

Criterion 11 - Management**Legal Standard**

The eleventh criterion for approval of the proposed merger is that management must be competent.

Finding

____ 30. The Petitioners and the Department have stipulated and we find that this criterion has been met. Letter to Board dated June 17, 2005.

Criterion 12 - Knowledge, Experience and Ability**Legal Standard**

The twelfth criterion for approval of the proposed merger is that the company must have the technical knowledge, experience and ability to provide the intended services.

31. The Petitioners and the Department have stipulated and we find that this criterion has been met. Letter to Board dated June 17, 2005

Criterion 13 - Reputation

Legal Standard

The thirteenth criterion for approval of the proposed merger is that the owner must have a good business reputation.

Findings

32. Verizon's business reputation is adequate to meet the standard. Docket No. 5900, Order of 2/26/97 at 16; Docket No. 6150, Order of 9/13/99 at 20.

Discussion and Conclusions

The Board found in two previous dockets involving merger transactions that the predecessor companies of Verizon owned good reputations. There is no reason to believe there will be a change in the good business reputation of Verizon following its acquisition of MCI. The record includes no evidence on which to conclude that this criterion has not been satisfied. Therefore the reputation standard is met.

Criterion 14 - Efficiencies

Legal Standard

The fourteenth criterion for approval of the proposed merger is that the merger should produce efficiencies in providing service.

Findings

33. By combining their largely complementary assets, the merged entity will produce efficiencies by allowing enterprise customers to purchase a broader array of services in a single transaction. Vasington pf. at 19-21; Hallbach pf. at 2.

Discussion and Conclusions

The Petitioners maintain that the merger will create efficiencies by giving large enterprise customers the ability to purchase more services in a single transaction than they could previously. Large enterprise customers will, they claim, be able to avail themselves of Verizon's wireless and

local exchange networks and MCI's global fiber network and IP backbone in a single transaction.¹⁶ The Petitioners further claim that these new combined products will eventually benefit small business customers.¹⁷

The Department's witness has testified that there is no reason to doubt Verizon's claims of efficiencies for large enterprise customers.¹⁸ However, the Department also argues that Verizon has failed to show how these efficiencies will benefit residential and small business customers who are currently MCI customers.¹⁹

We agree with the Petitioners and the Department that the merger will likely provide efficiencies for enterprise service customers. These customers will now be able to purchase a broad array of products from the same vendor in one transaction, resulting in cost savings for enterprise customers. In addition, because Verizon is not a significant competitor to MCI in the enterprise market, the merger will have little impact on competition in this area. Therefore, we conclude that the merger will produce efficiencies in this market sector and, thus, satisfies the criterion.

However, there is no evidence on which to conclude that these efficiencies will translate into cost savings for residential customers. Verizon states only that products developed for large enterprise customers can some day be delivered to small business customers with similar needs. The majority of MCI's residential customers are unlikely to have telecommunications needs similar to those of large enterprise customers. In addition, the immediate loss of a major competitor in the residential and small business market will remove any competitive pricing constraint formerly imposed by MCI on Verizon. Therefore, we cannot conclude that the merger will produce efficiencies for residential and small business customers.

16. Vasington pf. at 20.

17. *Id.* at 22.

18. Lackey pf. at 19.

19. Department Brief at 8-9.

Criterion 15 - Effect on Competition**Legal Standard, Discussion and Conclusions**

The fifteenth criterion for approval of the proposed merger is that the merger should not obstruct or impair competition. Because this is the standard that applies to the merger under Section 311, all findings and conclusions applicable to the fifteenth criterion are discussed below under that section. Based upon those findings and discussion, we conclude that the proposed merger, subject to certain conditions, will not impair or obstruct competition.

Summary: Section 107

We have concluded that the proposed merger meets each of the 15 criteria set out in the Board's Order in Docket No. 5900. We therefore conclude that the merger will promote the public good and should be approved under 30 V.S.A. § 107.

C. Section 311

Legal Standard

Board approval of a merger may be granted only upon a finding that the merger:

will not result in obstructing or preventing competition in the purchase or sale of any product, service or commodity, in the sale, purchase or manufacture of which such corporations are engaged.

30 V.S.A. § 311.

The Board's application of this statute has been influenced by whether the merger affects a competitive market. The Board has generally been receptive to mergers in competitive markets, and it has typically approved mergers proposed by nondominant companies. Mergers in competitive markets have been approved even when the effect is to reduce the number of competitors, so long as there remains a large number of competitors, barriers to entry are not high, and no competitor acquires substantial market power as a result of the merger.²⁰

20. For example, in a 1996 case, the Board permitted Avery Communications, Inc. ("ACI") to acquire operating control of Home Owners Long Distance, Inc. ("HOLD"). HOLD had been a regulated company reselling telecommunications services, a competitive market in Vermont. The Board reviewed the transaction under Section

(continued...)

Even where competition is restricted, the Board has been willing to approve mergers under certain circumstances. The Board has approved mergers where competition was possible but unlikely between the merging partners, so long as the merger did not exhaust or seriously deplete the pool of potential competitors.²¹

This case involves various market sectors. Because these markets have substantially different characteristics, we make separate findings and conclusions for each market.

Enterprise Services Market Competition

Findings

34. The large enterprise segment of the market consists of Fortune 1000 companies, federal government agencies, large state agencies, and similar sized institutions with multiple locations both nationally and internationally. Vasington pf. at 18; Hallbach pf. at 23.

35. Enterprise services customers purchase customized complex, integrated packages of voice and data services through competitive procurement or individually negotiated contracts. *Id.*

20. (...continued)

311 and approved the acquisition because ACI did not provide service in Vermont, and the transfer of control did "not reduce the level of competition within the state." *Joint Petition of Avery Communications, Inc. and Home Owners Long Distance, Inc.*, Docket 5895, Order of 11/5/96 at 4.

In 1993, the Board approved an acquisition that did reduce the number of competitors. The acquiring company had two subsidiaries in Vermont offering toll services, and the acquired company also had a subsidiary operating as a reseller in Vermont and elsewhere. The Board held that the transfer would enhance competition because it would enable WTC Communications, Inc. and its subsidiary "to pursue their marketing and business plans more effectively." *In re Rochester Telephone Corp.*, Docket 5785, Order of 3/13/95 at 5.

In another 1996 case, the Board again approved a merger that reduced the number of competitors. In *WorldCom*, the Board reviewed a merger between the parent companies of two different toll resellers. The Board approved the merger because it provided increased economies of scale. The Board noted, however, that the merger would not have any detrimental impact on competition because neither company was dominant in the intrastate toll services market, nor would they become dominant following the merger. *Joint Petition of WorldCom, Inc. and MFS Communications Co. Inc.*, Docket 5920, Order of 11/26/96.

21. For example, the Board approved a bulk sale of cable television property to another existing cable television company, even though the two companies might conceivably have come into direct competition through overbuilding of facilities. The Board concluded that even though competition was theoretically possible, it was, in fact, unlikely to occur under the circumstances. *In re Adelphia Comm. Corp., Inc.*, Docket 5247, Order of 7/22/88 at 96.

36. MCI is a leading provider of enterprise services to national customers. Vasington pf. at 18.

37. The enterprise market segment is widely recognized as highly competitive today. Hallbach pf. at 25.

38. Verizon, in part due to its regional network, rarely competes with MCI for these nationally and globally based customers. *Id.* at 26.

39. Verizon's local and regional presence and its substantial wireless services network, combined with MCI's enterprise services products and expertise, will allow the merged entity to provide a greater range of product offerings to enterprise customers. *Id.* at 28-29.

Discussion and Conclusions

The enterprise services market is unlike the mass market for telecommunications services. Whereas mass market customers often purchase bundled "off the shelf" offerings, enterprise customers purchase customized solutions based on particular business needs.²² In addition, enterprise customers often have multiple business locations located around the globe.²³ MCI, because of its global fiber optic network and global data capabilities, is able to compete effectively for enterprise customers today.²⁴ Verizon, on the other hand, with its lack of network reach and capability, is not a significant competitor for these types of customers.²⁵ Because the Petitioners rarely compete for enterprise customers today, it is unlikely that the merger will have much effect upon the market for these services. Accordingly, we conclude that the merger will not obstruct or impair competition in the enterprise services market.

Mass Market Competition

Findings

MCI's competitive status

22. Hallbach pf. at 23.

23. *Id.*

24. *Id.* at 29.

25. Vasington pf. at 15.

40. MCI provides more residential basic exchange access lines than any other competitive local exchange carrier ("CLEC") in Vermont, accounting for approximately 5% of the residential local telephone service market share in Vermont. Lackey pf. at 4.

41. MCI offers mass market basic exchange service for residential and commercial customers in Vermont largely under "The Neighborhood" plans. *Id.*

42. MCImetro Access Transmission Services, LLC, d/b/a The Neighborhood, built by MCI ("MCImetro"), is the primary CLEC subsidiary of MCI in Vermont. Hallbach pf. at 3.

43. MCImetro's most familiar offering is a suite of local and long distance offerings called "The Neighborhood." *Id.*

44. MCImetro's tariff on file with the Board contains descriptions and prices for various varieties of "The Neighborhood" offerings. The Vermont tariff includes descriptions and prices for both the intrastate and interstate calling components of the bundled offerings. *See* MCImetro, Vermont Tariff - P.S.B. No. 1.

45. MCI's mass market base has declined and will continue to shrink. Hallbach pf. at 7.

46. While MCI's mass market business is in decline, MCI continues to engage in telemarketing of the Neighborhood plans and serves a substantial number of customers in Vermont. Hallbach pf. at 7-22; tr. 10/7/05 at 48 (Lackey).

Intermodal Competition

47. Intermodal competition consists of offerings from cable companies, wireless providers, and broadband communications providers and VoIP carriers that provide an alternative to Verizon's service. Vasington pf. at 13-14.

48. Consumers today have more choices in communications services than ever before, and intermodal alternatives have displaced and are continuing to displace a significant amount of traditional wireline service and usage. Gordon pf. at 16-44.

49. There are a number of other services that are either available or developing in Vermont, but none of them provide a satisfactory competitive alternative for basic wireline services. Tr. 10/7/05 at 54-55 (Lackey).

50. Wireless service has more limited availability, inferior voice quality, a higher call drop rate, and more limited E-911 location capability compared to wireline service. *Id.*

51. Wireless service is considered by consumers to be a complement to, rather than a substitute for, wireline services. *Id.*

52. The competitive threat to wireline providers from VoIP in a largely rural state, such as Vermont, is limited. Lackey pf. at 16.

53. VoIP service, because it requires a relatively expensive broadband connection that is not available in many rural areas and will not work in a power outage, is not a true substitute for wireline service. Lackey pf. at 15-16; tr. 10/7/05 at 55 (Lackey).

54. Cable telephony has been slower to develop and is not yet available in Vermont. Tr. 10/7/05 at 54 (Lackey); Vasington pf. at 17.

Discussion and Conclusions

The Department maintains that the merger will produce no identifiable benefits for consumers of MCI's mass market services.²⁶ The Department argues that, despite its declining market share, MCI remains a substantial presence with thousands of Vermont customers.²⁷ The Department points out that MCI continues to market services in Vermont at the present time and provides more residential access lines than any other CLEC.²⁸ The Department argues that MCI's The Neighborhood plan represents a more competitively priced service than Verizon's Freedom plans.²⁹ The Department asserts that the Petitioners have overstated the competitive pressures exerted by wireless, VoIP, cable telephony, and other forms of intermodal competition.³⁰ Therefore, the Department argues, the loss of a significant competitor in the residential and small business market, combined with the lack of competitive alternatives for consumers, will only increase Verizon's already dominant market share and, thus, impair or

26. Department Brief at 9.

27. Department Reply Brief at 5.

28. Lackey Pf. at 4.

29. Department Brief at 20.

30. Department Brief at 12-16.

obstruct competition in this market.³¹ Given the lack of benefits to mass market consumers from the merger and the lack of competitive alternatives, the Department recommends that the Board impose a condition to protect existing MCI mass market customers. The Department recommends that the Board place a temporary price cap on MCI's Neighborhood plan for existing subscribers for a period of six to twelve months following the merger.³²

Petitioners maintain that because of MCI's declining mass market presence it is not a significant competitor today and, therefore, the loss of MCI as a competitor will not harm competition in Vermont. According to Petitioners, MCI's mass market business has declined and is continuing an irreversible decline.³³ This decline is due largely to increased long distance competition and regulatory changes affecting the price for leased facilities and telemarketing efforts.³⁴ MCI would not, the Petitioners argue, regardless of the merger, be a significant competitor for mass market services on a going forward basis.

Petitioners also assert that due to increasing intermodal competition in Vermont the loss of MCI as a competitor will not have an adverse affect on competition. The Petitioners maintain that the rapid growth of intermodal alternatives, such as cable and wireless, will provide the most significant mass market competition in the future and that these alternatives will replace any competitive pressure MCI would have otherwise exerted.³⁵

Petitioners maintain that the benefits from the merger to mass market customers, while not immediate, will occur over time.³⁶ The Petitioners argue that because MCI's Neighborhood rates are higher than Verizon's rates for comparable offerings, a price freeze or cap would accomplish nothing.³⁷ The Petitioners also assert that the imposition of a price cap on "The Neighborhood" plans would be jurisdictionally preempted with respect to the interstate portions

31. *Id.* at 22.

32. *Id.* at 9.

33. Hallbach pf. at 7.

34. *Id.*

35. Petitioners Reply Brief at 10.

36. *Id.* at 4.

37. *Id.* at 5.

of the plan, unjustly discriminatory pursuant to 30 V.S.A. 218(a), and only hasten MCI's exit from the mass market in Vermont.³⁸

There is no dispute that due in part to recent regulatory changes and competitive pressures MCI's mass market presence is in decline and it is likely that, in the absence of this merger, this trend would have continued. However, MCI is the largest CLEC in Vermont today, providing residential service to 5% of the market in Vermont. Regardless of MCI's decline, the merger will result in the loss of Verizon's largest competitor in the residential telecommunications market and, therefore, expose existing MCI customers to potential price increases due to the loss of competitive pressure.

The Board also concludes that the competitive pressure exerted by intermodal alternatives is insufficient to fully make up for the immediate loss of competition resulting from the merger. The Board recently reached a similar conclusion regarding intermodal competition in Docket No. 6959:

Cross-platform competition from services such as VoIP and wireless also has limitations. Wireless service is unavailable in many areas of the state due to the absence of cell towers. Moreover, customers generally view wireless as a complement to, rather than a substitute for, landline telephone service. VoIP also is limited because it relies upon an underlying broadband connection which many customers do not have available. It is also generally viewed as having lower quality than landline service. Further, VoIP does not yet reliably transmit E-911 locational information. Many of these hurdles are being addressed and, doubtless, VoIP-based competition will strengthen. But it is not now sufficient to prevent Verizon from increasing prices.

Verizon has also pointed to competition from cable providers. For the moment, such competition is prospective only. No cable company now offers telephone services (although cable-based broadband services are the platform for many users of VoIP). Once the sale of Adelphia is completed, it is possible that cable will emerge as a robust competitor. For the moment, it is not.

The evidence presented in this case has not persuaded us to alter this conclusion.

38. *Id.*

The Petitioners have stated throughout their testimony that they have no immediate plans to modify or discontinue existing product offerings including "The Neighborhood" plans.³⁹ However, the acquisition of MCI by Verizon will remove any incentive for MCI to maintain competitive pricing or to continue competing with Verizon's similar offerings. Without a price cap in place, the acquisition will afford Verizon a potentially unfair advantage should it seek to convert existing MCI customers to its own services.

The parties have offered differing testimony on the price comparison between "The Neighborhood" plans and Verizon's competitive offerings, and we make no conclusion as to the price differential here. If, as the Petitioners argue, MCI's plans are already priced higher than Verizon's competing plans, then the Petitioners should not object to a temporary price cap, because MCI's customers will likely switch to Verizon's plans. Without a price cap in place, Verizon will be able to raise rates for existing MCI subscribers while simultaneously touting the advantages of its own relatively lower priced plans. Therefore, we believe a temporary 12-month price cap on "The Neighborhood" plans for existing subscribers is necessary to maintain just and reasonable prices to these consumers in accordance with 30 V.S.A. § 218(a). Twelve months should provide ample time to allow existing MCI customers to make alternate arrangements, if necessary, and allow for increased growth of intermodal substitutes in the interim. The price cap will extend to all services, including the interstate portions of the bundled services, that are described in MCImetro's Vermont Tariff - P.S.B. No. 1, on file with the Board. While it is possible, as the Petitioners claim, the price freeze may act to hasten MCI's departure from the Vermont residential market, we conclude, based on MCI's relatively large customer base and its continued marketing of these plans in Vermont, that this is unlikely. Further, the Board concludes that, with the imposition of this condition, the merger will not impair or obstruct competition for mass market services.

Internet Backbone Competition

Findings

39. Tr. 10/7/05 at 26 (Vashington).

55. The Internet backbone acts like a large electrical transmission network carrying Internet traffic on a national and international basis. Tr. 10/7/05 at 34 (Vasington).

56. MCI is currently the fourth largest Tier 1 Internet backbone provider, with under 10% share of the Internet traffic. *Id.* at 38.

57. There are seven comparably sized national providers of Internet backbone service. *Id.*

58. Following the Merger Transaction, Verizon will become the fourth largest Tier 1 Internet provider. *Id.*

59. Peering arrangements between Internet backbone providers act to prevent unfair treatment of Internet traffic among Internet backbone providers. *Id.* at 36.

Discussion and Conclusions

The Board concludes that the merger will have little effect on competition among Internet backbone providers. Following the merger, Verizon will go from a company with a limited Internet backbone to the fourth largest Internet backbone provider. Due to the existence of several competing firms in this area and peering arrangements between these providers, the merger is unlikely to impair competition among Internet backbone services providers.

However, the acquisition of MCI's Internet backbone assets will put Verizon in position to selectively degrade Internet traffic routed over its backbone from competing telecommunications carriers. Cable, VoIP, and wireless providers that do not own their own internet backbone facilities will not be protected by peering arrangements among these carriers. Verizon's acquisition of MCI's Internet backbone will put the company in the position to selectively degrade the traffic of those competing carriers that need to access the Internet over Verizon's facilities. While the evidence presented in this case is unclear as to whether this is technically feasible, the potential remains that an Internet backbone provider could use its facilities to the detriment of competing telecommunications carriers and impair competition in this market. As the Board concluded in Docket No. 6101, "[f]reedom of the web, i.e., the broadest access possible for every subscriber, is vital for the future of Vermonters."⁴⁰ Therefore,

40. Dockets 6101/6223, Order of 4/28/00 at 141.

we condition approval of this merger upon Verizon providing fair and non-discriminatory treatment of all traffic routed over its Internet backbone.

Wholesale Market Competition

Special Access Rates

Findings

60. Special access services are among the service components that end users and carriers that serve end users rely on to provide business-oriented telecommunications services such as private lines, data transport, wide area networks, virtual private networks, multi-line basic exchange service, and toll access. Lackey pf. at 10.

61. Fewer than one percent of Verizon's special access circuits provided in Vermont are intrastate special access circuits; the remaining circuits are interstate and, therefore, not regulated by the Board. Tr. 10/6/05 at 108 (Vasington).

62. MCI does not provide special access facilities in Vermont. Tr. 10/6/05 at 17-18 (Hallbach) and at 107 (Vasington).

Discussion and Conclusions

The Department asserts that because the prices of special access services have not been examined or revised for some time, these prices may be set at levels that exceed Verizon's costs.⁴¹ Assuring that these services are available at reasonable prices, the Department argues, will counteract the concentration of market share that will result from the merger.⁴² Therefore, the Department recommends that the Board commence an investigation to determine whether Verizon's intrastate special access prices are reasonable, and to adjust those rates accordingly.⁴³

The Petitioners argue that the merger will have no adverse impact on special access services competition.⁴⁴ The Petitioners maintain that because MCI is not a competitor in the

41. Lackey pf. at 11.

42. *Id.*

43. *Id.*

44. Petitioners Reply Brief at 11.

provision of special access services, the merger cannot interfere with competition in this market or lead to market concentration.⁴⁵

The Board agrees with the Petitioners that, because MCI is not currently a provider of special access services, Verizon's acquisition of MCI will not impact prices or provision of service in this market. Therefore, we conclude that the merger will not obstruct or impair competition in the market for special access services. Accordingly we do not believe an investigation into special access rates is necessary at this time.⁴⁶ Especially, since we regulate fewer than one percent of Verizon's special access circuits provided in Vermont.

Extension of the Performance Assurance Plan ("PAP")

Findings

63. Verizon's wholesale service quality is currently measured by Carrier to Carrier standards of performance that govern Verizon's wholesale service offerings and a PAP. Docket No. 6959, Order of 9/26/05 at 135.

64. The PAP was developed to ensure that Verizon VT does not discriminate in the provision of unbundled network elements pursuant to interconnection agreements with competitive carriers. Tr. 10/6/05 at 104-05 (Vasington).

65. The PAP is a binding commitment by Verizon. Docket No. 6959, Order of 9/26/05 at 135.

66. Until the FCC's Triennial Review Remand Order ("TRRO"), MCI relied entirely upon Unbundled Network Elements - Platform ("UNE-P") as its means of providing basic exchange services to mass market customers. Lackey pf. at 4; Hallbach pf. at 11-12.

____ 67. Verizon VT provides services for which the FCC has found competitive carriers are not impaired under commercial agreements. Tr. 10/6/05 at 104-05 (Vasington).

Discussion and Conclusions

45. *Id.*

46. The Board makes no conclusion here as to whether Verizon's special access rates are just and reasonable. Should the Department continue to believe that an investigation of Verizon's special access rates is warranted, the Department should request an independent investigation of those rates following appropriate Board procedures.

The Department asserts that the TRRO has increasingly forced carriers, such as MCI, to enter into commercial agreements with Verizon to continue offering mass market services.⁴⁷ The Department argues that these commercial agreements are not subject to the PAP provisions and may include discriminatory terms and conditions.⁴⁸ Therefore, the Department recommends that the performance results of these commercial agreements be incorporated into the PAP measurements as a means of ensuring wholesale service quality.

The Petitioners argue that the Department has failed to identify any nexus between the proposed merger and Verizon's performance under commercial agreements.⁴⁹ The Petitioners also maintain that the Department's recommendation is beyond the scope of the Board's authority, inconsistent with the original purpose of the PAP, and unnecessary because Verizon is developing its own standards for commercial agreements.⁵⁰

The Board agrees with the Department that the increasing shift away from interconnection agreements to commercial agreements holds the potential for discriminatory treatment of competitors. However, we fail to see how the proposed merger will have any impact upon this trend. The fact that carriers, including MCI, are increasingly relying on commercial agreements to provide services bears little relation to the proposed merger. This trend, which is based largely on regulatory changes at the federal level, would have likely continued regardless of the proposed merger. Therefore, we reject the Department's recommendation and conclude that the merger will not obstruct or impair competition in the wholesale markets.

Summary: Section 311

We have concluded above that the proposed merger will not impair or obstruct competition in either the mass market, enterprise services market, internet backbone market, or wholesale market in Vermont. We therefore conclude that the merger will not obstruct or impair competition in Vermont and should be approved under 30 V.S.A. § 311.

47. Department Brief at 22-23.

48. *Id.*

49. Petitioners Reply Brief at 14.

50. *Id.*

III. CONCLUSION

Based upon the foregoing findings and discussion, we conclude, in summary that the proposed Verizon and MCI merger and related transaction, as conditioned, will promote the public good and therefore should be approved under 30 V.S.A. § 107. We also conclude that the merger and related transaction, as conditioned, will not result in obstructing or preventing competition in the purchase or sale of any product, service or commodity, in the sale, purchase or manufacture of which such corporations are engaged, and should be approved under 30 V.S.A. § 311, subject to the following conditions:

- (1) Pricing for all MCI mass market services offered under the MCI Neighborhood Plans are capped at current rates for existing subscribers for a period of one year.
- (2) Verizon must provide fair and non-discriminatory treatment to all users of its Internet Protocol backbone.

IV. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The proposed Verizon and MCI merger and related transaction, as conditioned, will promote the public good and is approved under 30 V.S.A. § 107.
2. The merger and related transaction, as conditioned, will not result in obstructing or preventing competition in the purchase or sale of any product, service or commodity, in the sale, purchase or manufacture of which such corporations are engaged, and is approved under 30 V.S.A. § 311.
3. Pricing for all MCI mass market services offered under the MCI Neighborhood Plans are capped at current rates for existing subscribers for a period of one year.
4. Verizon must provide fair and non-discriminatory treatment to all users of its Internet Protocol backbone.

Dated at Montpelier, Vermont, this 29th day of November, 2005.

<u>s/James Volz</u>)	
)	PUBLIC SERVICE
)	
<u>s/David C. Coen</u>)	BOARD
)	
)	OF VERMONT
<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: November 29, 2005

ATTEST: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.